Questions and Answers from the March 26, 2008 ftwilliam.com 403(b) webinar

There are 9 Q&As in this document; Q&A 6 is quite lengthy.
References to 403(b) "contracts" throughout this document include custodial accounts and retirement income accounts unless otherwise specified.

Q-1: Some public schools entities pay retirees unused sick and vacations days directly into their 403B account to avoid constructive receipt. FICA taxes are not accounted for. Will this be specified as non elective employer contributions in the doc?

A-1: The inclusion of Nonelective Employer contributions is an option in the full scope 403(b) document. The 403(b) regulations have a special rule allowing post-severance nonelective contributions to be made for up to five years after termination (1.403(b)-4(d)). For 415 limit purposes, the former participant is deemed to have monthly compensation after termination equal to the compensation for the prior year of service divided by twelve (note that there are particular rules in 403(b) about how to calculate a year of service).

However, please note that in order for these contributions to be considered non-elective, they must truly be non-elective. If employees are given the option of taking the unused sick time as cash or having it deposited into their 403(b) plan, then the contribution is an elective deferral - and 402(g) limits would apply. Retiring employees would likely have enough sick time to go over the 402(g) elective deferral limits, including any catch-ups as relevant.

If the unused sick time is truly a non-elective contribution, then you would need to ensure that the non-elective contribution allocation formula is "other" and both regular nonelective contributions (if applicable) are described as well as the unused sick time contributions for retired employees (with a careful definition of retired employee). Because the plan is sponsored by a public school (and is therefore governmental) the plan is not subject to nondiscrimination testing (whereas this arrangement certainly could cause problems for a plan that is subject to nondiscrimination). The remaining concern would likely be the 415 limits. The plan could limit the nonelective deferrals for retirees to the 415 limits or the plan could spread out the payments for up to five years after termination (ensuring that the 415 limits are not exceeded in any year).

Q-2: I'd like to see the differences in writing between a FICA Church and Church Plan.

A-2: There are three types of churches that could be implicated in a 403(b) plan so I'll do a comparison of all three:

Three types of Churches under 403(b) final regulations

	ERISA Church Plan	**FICA Church**	**Church-related organization**
Technical Meaning	ERISA Section 3(33)	Code section 3121(w)(3)(A) and (B). This definition is used to determine whether employees of a church are subject to FICA.	a FICA Church, a convention or association of FICA Churches, and organizations described in section 414(e)(3)(A)
Implications for 403(b) plan, in general	Exempt from ERISA (assuming the church has not elected to be covered under Code Section 410(d))	• Exempt from Universal Availability requirements • Exempt from nondiscrimination requirements • 401(a)(17)(B) compensation limits do not apply	• Plans established for Church related organizations are generally "403(b)(9)" Retirement Income Accounts • Are qualified organizations - employees may make special 403(b) catch-ups
Relationship to other "church" definitions	An ERISA Church is similar to a Church-related organization	A FICA Church is included in the definition of a Church-related organization. A FICA Church is more restrictive than a Church-related organization	A Church-related organization is similar to an ERISA Church. A FICA Church is included in the definition of a Church-related organization.

The definitions I use for FICA Church and Church-related organization are from the definition section of the 403(b) final regulations. The 403(b) final regulations refer to FICA Churches simply as "Church" - we added on "FICA" in order to clarify that FICA Churches are NOT the same as ERISA 3(33) churches and not the same as Church-related organizations under 414(e)(3)(A).

The ERISA Church plan definition is just from ERISA itself. There is a nice explanation of the general exemption for ERISA Church plans and Governmental plans in the preamble to the final regulations under the heading "Interaction Between Title I of ERISA and Section 403(b) of the Code" (towards the end of the preamble). In part it says: "... contracts purchased or provided under a program that is either a ‘‘governmental plan’’ under section 3(32) of ERISA or a ‘‘church plan’’ under section 3(33) of ERISA are not generally covered under Title I."

Q-3: What would you base allocations for post terminated ER NonElective contributions?

A-3: I'm assuming your question is related to how Compensation is determined after termination. Under 1.403(b)-4(d) (and in our Basic Plan Document), a former employee is deemed to have the same monthly compensation as the average monthly compensation in the last year of service (annual compensation divided by twelve). [If this did not answer your question, please let me know.]

Q-4: I'm combining two related questions:

A. If there has never been a plan document, do you make the effective date retroactive to the beginning of the plan or use the effective date of the new requirements?

B. Since many 403(b) plan sponsors, school districts in particular, will not have any plan document in place prior to January 1, 2009, how are you advising them to coordinate effective dates? For example School District X has ten 403(b) annuity providers and the District has no idea whether the individual products offer loans, hardships, etc. As of January 1, 2009 the District will be adopting its plan. I anticipate that the January 1, 2009 document will be effective for "all" [pre January 1, 2009, and on and after January 1, 2009 deferrals and benefits]. Do you concur? Or are there instances where the effective date should only be effective for deferrals and accruals on and after January 1, 2009? And if so, this would seem to create an administrative burden for the school districts.

A-4:

If there has never been a plan document, we recommend that the effective date of the new plan document should be January 1, 2009 for two reasons (i) we are not sure that you may legally provide for a retroactive date, and (ii) even if a retroactive date were feasible it could be a drafting nightmare since each plan change implemented after the retroactive effective date would have to be reflected in the document.

If a school district adopts a plan document on January 1, 2009 the changes if any to the in-service distributions will be effective January 1, 2009. The plan document would apply to all the money in plan, regardless of when it was contributed.

As an alternative, you could continue to make the pre-January 1, 2009 contributions to the plan subject to the pre-January 1, 2009 in-service withdrawal rules by specifying this in an addendum. Sample plan language would be: "Distribution rules specified in the Plan effective January 1, 2009 apply to contributions made on or after January 1, 2009. For contributions made before January 1, 2009, the terms of each contract shall determine whether in-service withdrawals are permissible." However, as you indicate this would likely be more of an administrative burden for most employers.

Q-5: If the employer can't authorize hardships, transfer, etc., who can? Can a TPA?

A-5: Let me first clarify for this question that I assume the plan is being sponsored by a nonprofit that is not a governmental plan and not an ERISA church plan but wishes to make use of the safe harbor and to be exempt from ERISA. Under the safe harbor, the employer cannot authorize a transfer or make discretionary determinations under the plan (determining hardship, etc). A third party could do this. Most typically, this would be a TPA or the plan vendor(s).

Q-6: Many school districts previously had 403(b) plans with multiple vendors and would now like to go to a single vendor approach. The problem is that the prior multiple vendors will not agree to sign information sharing agreements unless they are a permitted vendor under the new plan document. How can we then deal with participants that have money with an old vendor and with the new single vendor when the participants want a loan from the plan? How can we ensure we are not exceeding the maximum number of loans permitted under the plan? Could we use Participant loan applications to include certifications on the number of outstanding loans or at least warnings that if they have exceeded the maximum number of loans under the plan there could be adverse tax consequences? What's the "worst-case" scenario of what an employer could be responsible for?

A-6: In general, a contract that is not an authorized contract under the plan must enter into an information sharing agreement with the plan administrator/employer in order to hold funds under the plan. You are correct to seek information sharing agreements with former vendors that are no longer permitted investment options under the plan. However, there are exceptions to a full-fledged information sharing agreement for contracts that were issued prior to January 1, 2009 - depending on when the contracts were issued and under what circumstances.

Below, I will discuss the information sharing requirements for: 1) contracts issued after December 31, 2004 and before January 1, 2009 for active employees; 2) contracts issued after December 31, 2004 and before January 1, 2009 for former employees or beneficiaries; and 3) contracts issued before January 1, 2005 or contracts issued before September 24, 2007 pursuant to Revenue Ruling 90-24. After discussing the information sharing rules, we will discuss our recommendations for how to best proceed under these rules and, briefly, the consequences of not meeting the rules.

1. Contracts issued after December 31, 2004 and before January 1, 2009 for active employees:

Revenue Procedure 2007-71 provides that if there are active employees with investments in contracts issued after December 31, 2004 and before January 1, 2009, the "contract will not fail to satisfy section 403(b) for the year merely because the contract is not part of a written plan... if the employer makes a reasonable, good faith effort to include the

contract as part of the employer's plan." A "reasonable good faith effort... includes collecting available information concerning those issuers... and notifying them of the name and contact information for the person in charge of administering the employer's plan for the purpose of coordinating information necessary to satisfy section 403(b)." The vendor/issuer should make attempts to contact the employer before making a distribution or loan and exchange any information that may be necessary to meet 403(b) if the employer has not contacted the vendor/issuer.

2. Contracts issued after December 31, 2004 and before January 1, 2009 for former employees or beneficiaries:

If the contract issued before 2009 is for the benefit of former employees or beneficiaries, "the plan will not be treated as failing to satisfy the requirements of section 1.403(b)-3(b)(3) if the plan does not include terms relating to those contracts." The issuer is still required to make "reasonable efforts" to contact the employer before making a distribution or loan and exchange any information that may be necessary to meet 403(b). However, the employer is not required to make a reasonable, good faith effort to include the contract as part of the employer's plan. Vendors may not rely on employee certifications about outstanding loans and whether severance from employment has occurred if the employer is still in existence at the time of the distribution.

3. Contracts issued before January 1, 2005 or before September 24, 2007 if pursuant to a contract exchange under Revenue Ruling 90-24:

Employers and vendors with both of these types of contracts are not required to exchange information. Information is not required to be collected on contracts that were issued before January 1, 2005 per Revenue Procedure 2007-71. In addition, contracts that were issued before September 24, 2007 via a contract exchange permitted by Revenue Ruling 90-24 are grandfathered under the final regulations, section 1.403(b)-11(g). Revenue Ruling 90-24 contracts were allowed to be issued to vendors that were not specifically approved under the plan and this grandfathering rule takes into account that employers will often not have adequate information about these contracts' existence. These grandfathered contracts are not required to be maintained pursuant to a plan and employers are not required to make an effort to exchange information.

Recommendations

Although employers are only required to attempt to include contracts issued after December 31, 2004 and before January 1, 2009 for active employees in the plan, we suggest making this effort for all former vendors known to the plan. This could be accomplished with a letter including the name and contact information for the person in charge of administering the employer's plan. We also suggest including a reference to Revenue Procedure 2007-71 rules that require vendors to make "reasonable efforts" to contact the employer before making a distribution or loan and exchange any information that may be necessary to meet 403(b). This will put the vendors on notice of their duties. Some additional measures that could be taken include participant certifications and not

permitting loans or other hardship withdrawals for employees that have investments with uncooperative vendors. Each is discussed below.

Participant certifications: An alternative/additional step to try to ensure limitations on loans and hardship distributions are not exceeded could require Participant certifications before loans and hardship distributions are provided, as suggested in the question. As mentioned above, Revenue Procedure 2007-71 specifies that vendors may not rely on information from a participant or a beneficiary about outstanding loans if the employer is still in existence but does not address whether employers can rely on participant certifications if a prior vendor is uncooperative. If the employee certifications are done on top of a "reasonable good faith effort" to exchange information with the uncooperative vendors, the employee certifications may be another way to show that all efforts to gather the necessary information were made. One suggestion is to make the employee certifications subject to the penalty of employee discipline/termination. However, there is always the danger of employees not understanding what previous loans they may have taken or simply having inadequate record keeping.

No loans, hardship or any other in-service distribution allowed post January 1, 2009 for participants that have investments with uncooperative vendors: Under this scenario, participants can always transfer investments to the approved vendors and subsequently be allowed to make in-service distributions. Faced with potential loss of contracts due to the new rule the uncooperative vendors may suddenly see the benefit of an information sharing agreement. One drawback - many annuities have high surrender charges that would harm participants if they moved investments to a new vendor. Another drawback is that this may certainly seem unfair to the older employees that don't want to rearrange their contracts/accounts. NOTE: if the plan is subject to nondiscrimination this rule must pass the benefits rights and features test.

Other solutions we have heard include forcing employees to exchange investments from old vendors to new/approved vendors or strongly suggesting that employees move their investments. We are not aware of any authority for employers to force a change of investment within the same plan.

Consequences of not making a "reasonable good faith effort" or otherwise sharing information as may be required

If the employer fails to make a "reasonable good faith effort" to share information with a pre-2009 contract (if applicable) and limits on the number of loans are exceeded or another "operational failure" is made, the failure adversely affects all of the contracts issued by the employer to the employee involved. The premiums paid for the contract will be included in the gross income of the employee in accordance with section 83 (to the extent they have vested). However, a contract could also operationally fail if the vendor fails to contact the employer before distributing funds or making a loan. This is obviously entirely outside the control of the employer and is the reason we suggest putting the vendor on notice of his or her new duties under Revenue Procedure 2007-71 whenever possible.

Q-7: Off subject, but is your view that you can terminate a 403(b) plan now, or not until the plan year beginning in 2009?

A-7. A plan can be terminated anytime after July 26, 2007. The preamble to the final regulations clarifies:

> ... the special rule at § 1.403(b)–10(a) of these regulations permitting accumulated benefits to be distributed on plan termination can be relied upon only if all of the contracts issued under the plan at that time satisfy all of the applicable requirements of these regulations (other than the requirement at § 1.403(b)–3(b)(3)(i) of these regulations that there be a written plan).

Q-8: Can a TPA that purchases a single 403(b) document from you, have access to the forms at different times of the year when client asks for them or should I print them all out and save for future reference?

A-8: If you purchase a single document, you will have access to all the forms, etc. for a calendar year. You are charged $175 per Adoption Agreement generated. Note that you can generate a checklist to review your answers prior to generating an Adoption Agreement at no additional cost.

If you are new to our products, please consider signing up for a demo at https://www.ftwilliam.com/demo.html. The demo allows you to click around in our system and get a feel for all the options that are available without cost. Please also feel free to contact us either at 1(800) 596-0714 or at sales@ftwilliam.com with any general system questions / questions about subscribing to our services. It is also possible to set up a one-on-one demonstration with you to show you some of the features of the software.

Q-9: After I have completed the on line checklist for a 403(b) plan, can I print out the checklist to review before we have the system print the 403(b) plan adoption agreement?

A-9: Yes. This is available under the edit/print menu for the particular plan - at the very bottom right.